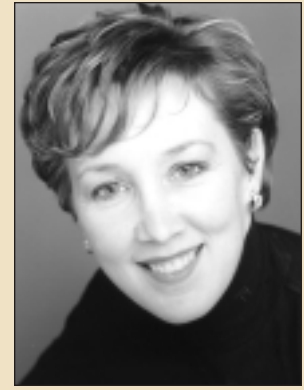


## INTERNATIONAL INTERESTS

Carolynne R. Maguire



### Non-Resident Vendors: The Big Holdback

In residential conveyancing, there are numerous circumstances in which funds must be retained in trust after the transaction is completed, most of them by agreement between the parties. None, however, is more onerous on vendors than that contemplated by section 116(5) of the *Income Tax Act* (the “Act”) to protect a purchaser from potential tax liability when said vendor is a non-resident of Canada. Being a statutory requirement, agreement has little to do with it.

While it is not the role of the purchaser or his or her legal representative (“rep”) in a conveyance to *determine* the vendor’s residency as at completion, it is incumbent upon them to make reasonable inquiry into the matter. Unfortunately, under the pressures of negotiation, the residency check-boxes on the standard form of contract of purchase and sale are often left unchecked or are completed inaccurately. Accordingly, it is reasonable and prudent for the purchaser’s rep to request that a statement be made under oath as to the vendor’s residency.

The onus is on the vendor to satisfy the purchaser’s inquiry if there should reasonably be suspicion on the part of the purchaser that a vendor’s statement

of being resident is false, whether out of ignorance or avoidance of the potential holdback.

Although rarely necessary, a formal “Determination of Residency” can be requested from International Tax Services. In any event, once it is determined that a vendor is non-resident, the vendor is obligated to apply to Canada Customs and Revenue Agency (CCRA) for issuance of clearance certificate(s) (“Certificate”).

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The purchaser will require receipt of same prior to closing or must hold back from sale proceeds an amount contemplated by the Act to be protected against potential liability until such certificates are obtained.

Based primarily upon its use, the acquired property may be comprised of either one or two categories with

differing holdback requirements. The general rule of thumb is that if the property had never been income-producing and was occupied only by family members for personal use, the holdback need only be 25 percent of the sale price and only one Certificate will be issued per non-resident vendor.

Alternatively, the holdback must be calculated as 25 percent of land value and 50 percent of improvement value, usually pro-rated from current assessed values to actual price, and a Certificate for each will be issued per non-resident vendor. When in doubt, the latter will prevail. It has been suggested that a statutory declaration or representation of some sort on behalf of the vendor as to the property’s use would be prudent when allowing the 25 percent holdback, if a letter of confirmation from CCRA (when already processing the application) is not available.

It is important to distinguish between the potential tax liability of the vendor and the statutory holdback requirements of the purchaser. Attempts may be made to dissuade the conveyancing rep from retaining the appropriate holdback because “the vendor lost money so there won’t be any tax.”

Even if this is apparent, the purchaser's protection should not be waived or reduced as CCRA will be circulating the application internally to ensure that all Canadian taxes have been paid in respect of other Canadian transactions by the same vendor. At the other extreme and although attempted by some conveyancing reps, there is rarely justification for a full 50 percent-of-sale-price holdback in a residential transaction unless dealing with a non-resident trader of land.

Whether the holdback is retained in the trust account of the purchaser's rep or vendor is at the option of the conveyancing rep. If it is agreed that the vendor's rep will hold it (perhaps to earn interest for his client), the undertaking must stipulate the amount and conditions upon which it is held so as not to prejudice the purchaser's position by lack of control. It must be possible for the conveyancing rep to compel timely remittance to CCRA or return to self of the funds being held to protect the purchaser.

Technically, funds withheld from the vendor in this regard are to be remitted to CCRA within 30 days after the end of the month in which the purchaser acquired the property, unless a Certificate or Certificates have been issued.

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Current practice at some of the Non-Resident Section Offices provides that if CCRA is already processing the vendor's application for clearance, they will ask not to receive it until the Certificate(s) are ready and then only the amount of tax payable, if any. Upon request, a letter can be issued by CCRA authorizing continued retention of the holdback until further notice.

If the vendor has been remiss in making application for clearance (which is technically to be done not later than 10 days after closing), CCRA may require remittance of the full holdback. Although entitled to do so, CCRA does not normally assess interest and/or penalty if the holdback is remitted after the 30-day period.

Except as described above, the holdback would only be released upon issuance of the Certificate(s). If no funds are required, CCRA will make the Certificate(s) available directly to the vendor applicant. Alternatively, CCRA will exchange the Certificate(s) for the amount of tax due, payable out of the holdback.

Clearly the impact of such a significant holdback can affect the viability of a transaction. Vendors with any question as to residency should be counselled early to satisfy themselves as to their position in that regard, perhaps with professional assistance from an accountant. If it is determined that they

are non-resident, they should be encouraged to make application for clearance as soon as possible to reduce the potential holdback period.

Applications can be filed upon an accepted offer but most prefer to wait until the agreement is firm. Turnaround time for issuance of Certificate(s) varies but can be up to eight or 10 weeks from application, depending on file complexity and CCRA workload.

Hardship provisions may apply (subject again to local Non-Resident Section policy) in the event that usual turnaround times would not allow for Certificate(s) to be issued prior to completion and the vendor's financial position could not support both the required holdback and full repayment of mortgage and/or other transactional obligations.

The onus of proof of hardship—that the transaction cannot complete without prior issuance of the Certificate(s) and may collapse the agreement—rests with the vendor. If

successful, however, and the application is not complicated by elections or lack of complete information, Certificate(s) can sometimes be issued within days.

Beyond reference to the Act itself or a call to the relevant Non-Resident Section Office, resources and publications are available online through the CCRA Website ([www.ccra-adrc.gc.ca](http://www.ccra-adrc.gc.ca)), including the following bulletins and forms of particular note.

### **Bulletins**

#### **72-17R4**

Procedures Concerning the Disposition of Taxable Canadian Property by Non-Residents of Canada, Section 116 (04/92)

*(Considered by those in the non-resident section to be somewhat “out of date” but will likely not be replaced for awhile yet.)*

#### **IT-221R3**

Determination of an Individual's Residence Status

### **Forms**

**T2062:** Request by a Non-Resident of Canada for a Certificate of Compliance

Related to the Disposition of Taxable Canadian Property

**T2062A:** Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Canadian Resource or Timber Resource Property, Canadian Real Property (Other than Capital Property), or Depreciable Taxable Canadian Property

**T2091:** Designation of a Property as a Principal Residence by an Individual

**NR73:** Determination of Residency Status (Leaving Canada)

**NR74:** Determination of Residency Status (Entering Canada) ▲

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